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UNITED STATES DISTRICT COURT

CENTRAL DISTRICT OF CALIFORNIA

SOUTHERN DIVISION

PAUL RICE and JOSEPH RICE,

Plaintiffs,

v.

CHARLES SCHWAB; MOODY'S INVESTORS SERVICE; STANDARD & POOR's, DOES 1 through 50, Inclusive,

Defendants.

Case No. SACV 10-00398 CJC (MLGx)

DEFENDANTS' JOINT REPLY MEMORANDUM OF LAW IN SUPPORT OF MOTION TO DISMISS THE SECOND AMENDED COMPLAINT

Date: October 25, 2010
Time: 1:30 p.m.
Place: Courtroom 9(B)

Hon. Cormac J. Carney

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Defendants Standard & Poor's Financial Services, LLC ("S&P") and Moody's Investors Service, Inc. ("Moody's") (collectively, the "CRAs") respectfully submit this joint reply memorandum of law in further support of their joint motion to dismiss, pursuant to Fed. R. Civ. P. 9(b) and 12(b)(6), the Second Amended Complaint (the "SAC") filed by plaintiffs Paul Rice and Joseph Rice (the "Plaintiffs").

I. INTRODUCTION

Plaintiffs do not (and cannot) deny that their SAC contains only ***two*** substantive changes from their previously dismissed complaint: (i) an assertion that the CRAs' ratings were "directly communicated" by the CRAs to Plaintiffs (¶16), and (ii) a statement of the dates on which Plaintiffs purportedly obtained the respective CRAs' credit ratings and Plaintiffs' location at the time they obtained those ratings. *See* SAC ¶ 29. Tellingly, Plaintiffs barely address these new allegations in their opposition brief. Nor do they even attempt to rebut the arguments in the CRAs' opening brief that the new allegations are immaterial and come nowhere near the threshold for stating a claim.

Rather, Plaintiffs spend the bulk of their brief rehashing other previously asserted allegations that (i) the CRAs represented through their published ratings that Fannie Mae and Freddie Mac securities would be "safe" and had an "extremely low" likelihood of default (¶30), and (ii) that the CRAs "knew" their ratings on those securities were "false." *See* ¶31. What Plaintiffs fail to acknowledge is that these very same allegations were contained, *word-for-word*, in their First Amended Complaint, which was dismissed by the Court on August, 4, 2010. *Compare* SAC ¶30 with FAC ¶29; and SAC ¶31 with FAC ¶¶18, 30. Obviously, Plaintiffs cannot revive their claims by realleging the very allegations made in their dismissed FAC.

It is telling that Plaintiffs have failed to make any new arguments to address the various bases for dismissal advanced by the CRAs, *i.e.,* that there was no duty of care between Plaintiffs and the CRAs; that the remaining elements of negligent

misrepresentation and fraud are not alleged; and that their claims are barred by the Credit Rating Agency Reform Act of 2006 ("CRARA") as well as the First Amendment to the U.S. Constitution. Indeed, aside from the discussion of two cases (distinguished below), Plaintiffs' brief repeats verbatim, with the exception of several cosmetic changes, the precise arguments they previously put forth in support of their dismissed FAC. *Compare* Plaintiffs' Opposition ("Pl's Opp.") Section A-C, E, and G-J *with* Memorandum of Points and Authorities In Support of Plaintiffs' Opposition to the Rating Agencies, Joint Motion to Dismiss the First Amended Complaint Pursuant to Fed. R. Civ. P. Rules 12(b)(6) and 9(b) A-D and F-I. Plaintiffs' decision to rehash without substantive change the arguments previously made flies in the face of the Court's express admonition that Plaintiffs "may wish to consider some of the CRAs' other arguments" should they choose to amend. *See also Paul Rice et al.* v. *Charles Schwab et al.*, No. 10-00398-CJC, slip op. at 2 (C.D. Cal. Aug. 4, 2010) ("August 4 Order") (Docket No. 34).

For the reasons set forth below, Plaintiffs' SAC must be dismissed with prejudice.

II. ARGUMENT

A. THE CRAS DID NOT OWE PLAINTIFFS A DUTY OF CARE UNDER EITHER NEW YORK OR CALIFORNIA LAW

As set forth in the CRAs' opening brief, the relationship required to allege a duty of care under New York law is one of privity or its functional equivalent.[1]

[1] Plaintiffs incorrectly assert that *Erie Railroad Co.* v. *Tompkins*, 304 U.S. 64, 58 S. Ct. 817, 82 L.Ed. 1188 (1938) mandates application of California law to their negligent misrepresentation claim merely because this action was removed from a California State Court. Pl's Opp. at 5. The law is clear, however, that while a federal court sitting in diversity must look to the forum state's choice of law rules to determine the controlling substantive law, it certainly need not apply the forum state's substantive law. *Precision Safety Innovations, Inc.* v. *Branson Ultrasonic Corp.*, 2005 WL 5801513, *4 (C.D. Cal. 2005). As demonstrated in the CRAs' opening brief, (The Rating Agencies' Joint Memorandum of Points and Authorities In Support of Their Motion to Dismiss the Second Amended Complaint (the "Opening Brief") at 5 n.3), California's choice of law rules mandate the application of New York law here, although as demonstrated below, Plaintiffs' negligent misrepresentation claim fails under the law of either state.

See, e.g., Ultramares Corp. v. *Touche*, 255 N.Y. 170, 182-83, 174 N.E. 441, 446 (1931). Under California law, a plaintiff must allege that it was a member of a "limited group of intended beneficiaries" of the defendant's representation in order to demonstrate the existence of a duty of care. *Bily* v. *Arthur Young & Co.*, 3 Cal. 4th 370 (1992). Plaintiffs, effectively conceding that they cannot meet the standard under New York law, do not even address it. Nor can they even come close to satisfying the California test, which follows Restatement (Second) of Torts, Section 552. Plaintiffs do not (and cannot) point to any facts in the SAC that even begin to suggest they were members of a "narrow and circumscribed class of persons to whom or for whom the misrepresentations were made," *Bily*, 3 Cal. 4th at 408, and do not once allege any contact with the CRAs. As noted, they argue instead that a duty of care existed in this case because they were "part of the class (investors) that rely on the Defendants' ratings to make investment decisions." *See* Pl's Opp. at 6.

But there is nothing at all "narrow and circumscribed" about a "class of investors" that may have consulted the CRAs' broadly published opinions. This "class" would have no reasonable or principled boundaries and would include many millions of potential investors around the world, not to mention other potential users of credit ratings such as entities that did business with, or extended credit to, Fannie Mae and Freddie Mac. Moreover, there are no facts alleged in the SAC to demonstrate — as required under both California and New York law — that either of the CRAs specifically intended to provide their ratings of Fannie Mae and Freddie Mac to these specific Plaintiffs. *See, e.g., Bily*, 3 Cal. 4th at 394-95 (observing that Section 552 was intended to "'eliminate the liability to the very large class of persons whom almost any negligently given information may foreseeably reach and influence, and limit the liability, not to a particular plaintiff defined in advance, but to the comparatively small group whom the defendant expects and intends to influence'") (quoting Restatement (Second) of Torts, Draft

No. 11 § 552 at 56 (Apr. 15, 1965)).[2] *See also In re Enron Corp. Securities, Derivative & "ERISA" Litigation*, 511 F. Supp. 2d 742, 826 (S.D. Tex 2005) (citing Comment (h) to Section 552 and noting that 552 "subjects the negligent supplier of misinformation to liability only to those persons for whose benefit and guidance it is supplied. . . . It is not enough that the maker knows of the ever-present possibility of repetition to anyone, and the possibility of action in reliance upon it, on the part of anyone to whom it may be repeated."); *id.* at 827 ("[A]llowing anyone to sue credit rating agencies who had read the credit rating reports and claimed to have relied upon them and lost money in any endeavor that person undertook would be far more deleterious than beneficial to society as a whole."). Instead, Plaintiffs offer only the unsupported, conclusory allegation that "Defendants specifically intended that the Plaintiffs would rely on their credit ratings." Pl's Opp., at 7 (citing the SAC at ¶ 23). This allegation has already been tried and failed. *Compare* SAC ¶ 23 *with* FAC ¶ 23.

This result is also grounded in well-settled public policy. If plaintiffs could state a claim based on the sort of allegations at issue here, it would have an overwhelming chilling effect on the willingness of any party (not just the CRAs) to publish statements of opinion to the market as a whole. *Ultramares Corp.* v. *Touche*, 255 N.Y. 170, 174 N.E. 441, 444 (1931) (noting the unacceptable prospect of "liability in an indeterminate amount for an indeterminate time to an indeterminate class"). In *Gutter* v. *Dow Jones, Inc.*, 22 Ohio St. 3d 286, 490 N.E.2d 898 (Ohio 1986), for example, the court dismissed a negligent misrepresentation claim brought against a newspaper by an investor. The plaintiff

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[2] In the section of their brief regarding duty of care, Plaintiffs curiously cite two cases, *Cohen* v. *S&S Construction Co.*, 151 Cal. App. 3d 941 (4th Dist. 1983) and *Gagne* v. *Bertran*, 43 Cal. 2d 481 (1954) , which have no bearing on — and do not even address — the issue of duty. These cases (addressed more fully below) stand for the proposition that in certain instances, with facts totally distinguishable from those in this case, statements of opinion can constitute actionable statements of fact.

claimed to have relied to his detriment on a report in the newspaper that certain corporate bonds were "trading with interest." He alleged that the defendant publisher "knew, or should have known" the report was inaccurate and that it published the report "with the intent that investors rely" on it in making financial decisions. *Id.* at 287. Dismissing the claim, the court concluded that "as a newspaper reader, appellee does not fall within a special limited class (or group) of foreseeable persons as set forth in Section (2)(a) [of Section 552]." *Id. See also Ginsburg* v. *Agora, Inc.*, 915 F. Supp. 733, 739 (D. Md. 1995) (dismissing negligent misrepresentation claim on the grounds that "[t]he publication is offered to the general public and the information provided in the publication is of a general nature, that is, it is not specifically tailored to [the] financial situation of any individual subscriber"); *Stancik* v. *CNBC*, 420 F. Supp. 2d 800, 807-08 (N.D. Ohio 2006) (granting motion to dismiss action brought by viewer against financial cable television network, noting that "[a] contrary result would in effect extend liability to all the world and not a limited class"). As demonstrated in the CRAs' Opening Brief the SAC establishes that the ratings, much like the alleged misrepresentations at issue in the cases cited to above, were widely "published . . . to the market at large" Opening Brief at 7. *See also, e.g.,* SAC at ¶¶ 17-19 (acknowledging the widespread dissemination of the ratings assigned to Fannie Mae and Freddie Mac because Moody's and Standard and Poor's "published the ratings").

The same public policy principles are applicable here. Accordingly, Plaintiffs can establish no duty owed by the CRAs.

B. PLAINTIFFS FAIL TO ALLEGE ANY OF THE OTHER ELEMENTS REQUIRED TO STATE A CLAIM FOR NEGLIGENT MISREPRESENTATION OR FRAUD

Plaintiffs cannot, in any event, establish the other elements required to state a claim for negligent misrepresentation or fraud including, most glaringly, the existence of any misstatement of fact. As noted, Plaintiffs offer no basis upon which to distinguish, and thereby tacitly acknowledge the applicability of, the

unbroken line of recent cases holding that credit ratings are statements of opinion that cannot constitute actionable misstatements unless made by a speaker who actually disbelieves those opinions. Specifically, the court in *In re Lehman Bros. Securities & ERISA Litigation*, 684 F. Supp. 2d 485, 494-95 (S.D.N.Y. 2010) recognized that a credit rating is not a fact, but rather "a statement of opinion by each ratings agency," and is therefore not actionable absent factual allegations sufficient to support a finding that the "ratings agencies did not truly hold those opinions at the time they were made public." This holding has been echoed in numerous other recent decisions:

- "Credit ratings . . . are statements of opinion, as they are predictions of future value and future protection of that value." *New Jersey Carpenters Vacation Fund* v. *Royal Bank of Scotland Group, PLC*, 2010 WL 1172694, at *14 (S.D.N.Y. Mar. 26, 2010).
- "[C]redit ratings and the adequacy of credit enhancements are clearly opinion statements because they predict future value and reliability . . . and are not actionable unless it is alleged that the opinions were not truly held." *New Jersey Carpenters Health Fund* v. *Residential Capital, LLC*, 2010 WL 1257528, at *6 (S.D.N.Y. Mar. 31, 2010).
- "Ratings are opinions." *In re IndyMac Mortgage-Backed Securities Litigation*, 2010 WL 247 3243, at *11 (S.D.N.Y. Jun. 21, 2010).
- "[W]hether the 'credit quality of the mortgage pool' was 'properly considered' or 'adequate' to support a particular rating was not a matter of objective fact." *Tsereteli* v. *Residential Asset Securitization Trust 2006-A8*, 692 F. Supp. 2d 387, 394-95 (S.D.N.Y. 2010).
- "[T]hese are statements of opinion, not facts." *New Jersey Carpenters Health Fund* v. *DLJ Mortgage Capital, Inc.*, 2010 WL 1473288, at *8 (S.D.N.Y. Mar. 29, 2010).

Nor do Plaintiffs make any effort to deal with other cases, such as the Sixth Circuit's decision in *Compuware Corp.* v. *Moody's Investors Services, Inc.*, 499 F.3d 520, 529 (6th Cir. 2007), holding that a credit rating "is a predictive opinion, dependent on a subjective and discretionary weighing of complex factors" and "communicates [no] provably false connotation."

The decisions in *Abu Dhabi Commercial Bank* v. *Morgan Stanley & Co.*, 651 F. Supp. 2d 155 (S.D.N.Y. 2009), and *King County, Washington* v. *IKB Deutsche Indus, AG,* 2010 WL 1702196 (S.D.N.Y. Apr. 26, 2010), *see* Pls' Opp. 9-10, which involved vastly different allegations than those made here, are therefore entirely inapposite. In *Abu Dhabi*, for example, the court found that plaintiffs had set forth in "painstaking[] detail" factual allegations about the structure, operations, and portfolio of the specific Structured Investment Vehicle (SIV) at issue and defendants' alleged ongoing responsibilities with respect to that SIV. *Abu Dhabi*, 651 F. Supp. 2d at 164-68, 178. Indeed, the *Abu Dhabi* court relied on the cumulative effect of, *inter alia*, allegations that: (i) the CRAs allegedly knew of departures from the specific "program guidelines" applicable to the SIV, *see id.* ("[D]efendants knew that although the actual portfolio consisted of 'much more' than fifty-five percent of RMBS, the Information Memoranda stated that the Cheyne SIV's portfolio would consist of no more than fifty-five percent of such securities."); (ii) the "Rating Agencies were in possession of non-public information that would have contradicted the assignment of high ratings to the Rated Notes"; and (iii) "the Rating Agencies were compensated . . . at a fee substantially higher than normally received and a fee that was directly connected to the success" of the SIV. *Id.*, at 178.[3] While the CRAs maintain that the allegations

[3] In *King County, Washington* v. *IKB Deutsche Industriebank AG et al.*, 2010 WL 1702196 (S.D.N.Y. Apr. 26, 2010), a case brought by one of the same plaintiffs as in *Abu Dhabi* and involving the same kinds of detailed factual allegations about a second SIV, the court simply cross-referenced its decision in *Abu Dhabi* and reached the same conclusions. *Id.*

in *Abu Dhabi* and *King County* will ultimately be proved to be without merit, those allegations are not at all comparable to the vague and unsupported allegations that Plaintiffs assert here. In striking contrast to the complaints in *Abu Dhabi* and *King County*, Plaintiffs' SAC does not cite to a single specific fact about the CRAs' rating process for the Fannie Mae and Freddie Mac ratings at issue, but instead relies on vague and conclusory allegations that the ratings were based on "stale information," that the CRAs "knew" the ratings were "false" and that their "models" were "unreasonable." Pl's Opp., at 12.

In fact, allegations nearly identical to those made here were recently found to be insufficient as a matter of law by the court in *Freidus* v. *ING Groep N.V.*, 2010 WL 3554097 (S.D.N.Y Sep. 14, 2010). The plaintiff in *Freidus* alleged that the ratings at issue were false and misleading because they were based on "out-of-date" models, assumptions and data. *See Freidus*, 2010 WL 3554097, at *12 ("The CAC alleges that these statements 'did not accurately reflect the risk of default' and therefore were false and misleading because (i) the ratings were determined by out-of-date models based on out-of-date assumptions that used inaccurate data, and (ii) the ratings agencies relaxed their ratings criteria to get more business and were subject to conflicts of interest."). Analyzing these allegations under the more relaxed pleading standard of Rule 8(a), *see Freidus*, 2010 WL 3554097, at *5, and explicitly relying upon the court's prior decision in *In re Lehman Bros.*, the court found the complaint did not allege that the ratings were false or misleading. *Id.* Specifically, the court reiterated that credit ratings are opinions and that:

> Any given rating reflects the judgment of the particular rating agency that certain facts, when fed into a particular model based on a particular set of assumptions, support issuing a particular rating for a particular security. That opinion can be false or misleading only if the opinion-giver – here the rating agency – did not truly believe it to be the case at the time it was issued.

Id. Thus, mere allegations that the models, data or assumptions used to rate a specific transaction are unreasonable, out-of-date or pure speculation do not rise to

the level of specificity required.

Plaintiffs' failure even to discuss these recent decisions makes it clear that they simply have no way of rebutting the CRAs' argument on this fundamental and dispositive issue. Rather than addressing directly applicable law, Plaintiffs instead rely on older, inapposite, state court cases, including *Cohen* and *Gagne*, *supra* note 2, which do not involve rating agencies, or the sort of opinions about the future upon which they have chosen to sue. In *Cohen*, for example, the court held that plaintiffs could pursue a fraud claim against a real estate developer who allegedly misrepresented that a certain development had "panoramic views" while allegedly possessing facts establishing that it did not. *Cohen* v. *S&S Construction Co.*, 151 Cal. App. 3d 941, 946 (4th Dist. 1983) (citation omitted). This statement about the present condition of a piece of property is in no way comparable to an opinion about the future creditworthiness of debt issuers and securities. Plaintiffs' citation to *Gagne* v. *Bertran*, 43 Cal. 2d 481 (1954) is equally unavailing since that case involved undisputed statements of fact, not statements of opinion. The defendant in that case, unlike the CRAs here, was specifically retained by the plaintiff and did not offer an opinion at all. Rather, upon completion of his services — which involved taking soil samples at a prospective construction site — he sent plaintiff a letter containing certain verifiable facts which, according to the court, could constitute actionable misrepresentations. *Id.* at 485 ("[D]efendant represented and warranted to plaintiffs that there was no [soil] fill beyond 16 inches"). These decisions, involving representations wholly unlike the rating opinions at issue, would be unpersuasive even if there were not numerous contrary authorities dealing specifically with ratings and the very issue before this Court. They certainly provide Plaintiffs with no basis for ignoring – or refuting – these authorities.

Plaintiffs' only other case on this point is *In re Wells Fargo Mortgage-Backed Certificates Litigation*, 2010 WL 1661534 (N.D. Cal. 2010) ("*Wells Fargo I*"), in which the court dismissed claims against rating agencies (including the two

CRAs in this case), holding that the rating agencies were not "underwriters" or "controlling persons" for purposes of Sections 11 and 15 of the Securities Act of 1933 with respect to certain mortgage-backed certificates. The court initially allowed claims to proceed against the non-rating agency defendants, finding that the complaint included allegations "sufficient to establish an actionable misstatement with respect to the *rating process*." *Id.* at *12. (emphasis added). However, the *Wells Fargo* court just this week revisited the issue and brought its ruling into line with the overwhelming majority of recent decisions discussed at 6, 8, *supra*. *See In re Wells Fargo Mortgage Backed Certificates Litigation*, No. 09-CV-01376-LHK, slip op. at 6-7 (N.D. Cal. Oct. 5, 2010) ("*Wells Fargo II*"). Specifically, the court found that credit ratings are opinions and noted that "a number of other courts have reached the same conclusion." *Id.* The court further held that contrary to the *Wells Fargo* plaintiffs' assertion, ratings, as opinions, are subject to the "knowing falsity" standard set by *Rubke* v. *Capitol Bancorp LTD*, 551 F.3d 1156 (9th Cir. 2009) and *Virginia Bankshares, Inc.* v. *Sandberg*, 501 U.S. 1083 (1991). *Wells Fargo II*, slip op. at 6-7 ("[T]he *Virginia Bankshares* and *Rubke* decisions post-date *Apple Computer*, and set a more stringent standard for statements of opinion. . . . The Court concludes that the appraisals, ratings and LTV ratios are statements of opinion, and as such, are subject to the *Virginia Bankshares/Rubke* pleading standard."). Accordingly, plaintiffs seeking to hold a party liable for allegedly "false" opinions may *not* rely upon the tests set forth in *In re Apple Computer Sec. Litig.*, 886 F.2d 1109, 1113-14 (9th Cir. 1989), which are satisfied by allegations that the speaker had "no reasonable basis" for the opinion or "is aware of undisclosed facts tending to seriously undermine the accuracy of the statement." Thus, *Wells Fargo I*, upon which Plaintiffs heavily rely, has been superseded by *Wells Fargo II*, which — like all of the other decisions addressing this issue — compels dismissal of the SAC.

Plaintiffs' inability to state a claim is further highlighted by their failure even

to address, much less satisfy, Federal Rule of Civil Procedure 9(b), which requires both of their claims (negligent misrepresentation and fraud) to be pled with particularity. This means that Plaintiffs must allege not only "the time, place and content" of any alleged misrepresentations, but also the "circumstances indicating falseness." As demonstrated in the CRAs' Opening Brief, the most Plaintiffs can allege here are broad, conclusory assertions that, for example, the CRAs "had knowledge that [Fannie Mae and Freddie Mac] were in financial trouble and were bad risks" (SAC ¶18), and that "defendants knew the ratings were false because the models, data and assumptions used to rate Fannie Mae and Freddie Mac were unreasonable, false, and based on pure speculation." Pl's Opp. at 10. In addition to their other dispositive failings, Plaintiffs' claims are insufficient as a matter of law because there are no facts alleged to support these sweeping and conclusory assertions, *i.e.*, there is no effort to allege *why* or *how* the CRAs' models, data and assumptions were "unreasonable" or "false" or "speculative," and no discussion at all about the "circumstances" surrounding these alleged misstatements.

Indeed, Plaintiffs all but admit that they have no actual facts to support these allegations by making their assertions "upon information and belief" — a fact that by itself requires dismissal given the lack of any supporting factual basis. *See Clemens* v. *DaimlerChrysler Corp.*, 2006 WL 6022681, at *1 (C.D. Cal. 2006) ("Fraud allegations based on 'information and belief' do not satisfy the particularity requirements of Rule 9(b), unless the complaint sets forth the facts on which the belief is founded.") (citing *Comwest, Inc.* v. *American Operator Services, Inc.*, 765 F. Supp. 1467, 1471 (C.D. Cal. 1991)). Ultimately, Plaintiffs' allegations amount simply to an expression of their view that, looking back, the ratings on securities they purchased should have been lower. Such allegations fall far short of stating a claim for either negligent misrepresentation or fraud.[4]

[4] Plaintiffs also do nothing to cure the SAC's dispositive failure under Rule 9(b) to distinguish among multiple defendants instead of grouping allegations

C. THE CREDIT RATING AGENCY REFORM ACT OF 2006 PREEMPTS PLAINTIFFS' NEGLIGENCE-BASED CLAIMS

Plaintiffs also continue to offer no meaningful response on the issue of preemption. They again do not even address the decisions — including U.S. Supreme Court decisions — cited in the CRAs' Opening Brief, which demonstrate that the CRARA preempts state negligent misrepresentation claims. Instead, Plaintiffs rely exclusively on *In re National Century Financial Enterprises, Inc., Investment Litigation*, 580 F. Supp. 2d 630 (S.D. Ohio 2008) ("*NCFE*"). In *NCFE*, however, the court, noting that the issue had received "little briefing" in that case, expressly stated that it was "refrain[ing] from deciding the issue until it has the benefit of full briefing from the parties." 580 F. Supp. 2d at 651-52. Moreover, the *NCFE* court recognized that the CRARA prohibits states from "tell[ing] [CRAs] what ratings they should give or dictat[ing] how they arrive at their ratings." *NCFE*, 580 F. Supp. 2d at 651. Yet that is precisely what common-law actions seeking damages do and have repeatedly been held to do. *See* Opening Brief at 16-20.

As demonstrated in the CRAs' Opening Brief, a recent law review article on the preemptive effect of the CRARA concludes that "[b]oth Supreme Court jurisprudence and the ordinary meaning of 'regulate' point toward construing that word to include private causes of action in the context of a preemption clause." Timothy M. Sullivan, Note, *Federal Preemption and The Rating Agencies: Eliminating State Law Liability to Promote Quality Ratings*, 94 Minn. L. Rev.

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against "Defendants" as a group. *See, e.g.*, SAC, at ¶¶ 30-31. As noted in the CRAs' Opening Brief, this alone is grounds for dismissal. *See Swartz* v. *KPMG LLP*, 476 F.3d 756, 765 (9th Cir. 2007) ("Rule 9(b) does not allow a complaint to merely lump multiple defendants together but 'require[s] plaintiffs to differentiate their allegations when suing more than one defendant . . . and inform each defendant separately of the allegations surrounding his alleged participation in the fraud.' In the context of a fraud suit involving multiple defendants, a plaintiff must, *at a minimum*, 'identif[y] the role of [each] defendant [ ] in the alleged fraudulent scheme.'") (emphasis added and citations omitted).

2136, 2153 (June 2010). The article states, after detailed analysis of the CRARA language and relevant cases, that it was likely that "Congress intended to preempt all claims against rating agencies registered as NRSROs except enforcement actions brought by regulatory agencies on theories of rating agency fraud or deceit." *Id.* at 2156. Such preemption, the article explains, reflects the Congressional goal of improving ratings quality in part by promoting uniformity across jurisdictions.

Careful examination of the legislative purpose behind the CRARA fully supports application of its preemptive effect on this case. In adopting the CRARA, Congress determined *not* that NRSROs should be free from regulation, but that the SEC was the appropriate body to do the regulating. *See* H.R. Rep. No. 109-546, at 14 (2006) ("NRSROs will be held accountable under the securities laws: The SEC will be able to inspect, examine, and bring enforcement actions against rating agencies under the 1934 Act."). Congress also expressed, in the clearest language, its intent to preserve the credit ratings agencies' independence in reaching rating opinions and to protect their underlying procedures and methodologies. *See* H.R. Rep. No. 109-546, at 14 (2006) ("Congress and the SEC must be cautious not to intrude into the ratings procedures and methodologies. H.R. 2990 does not intrude into these procedures and the Manager's Amendment expressly affirms that the SEC may not intrude into the ratings procedures and methodologies.").[5]

[5] Plaintiffs also incorrectly portray the CRAs' argument with respect to CRARA preemption. Contrary to Plaintiffs' assertion, the CRAs do not anywhere assert blanket immunity "from any state activity that could impose ratings-related liability." Pl's Opp., at 15. Rather, the CRAs acknowledge that Congress struck a balance by which it precluded private rights of action arising from ratings-related activity – the CRARA does not foreclose the possibility of governmental enforcement actions arising from alleged fraud or deceit on the part of the CRAs. See Opening Brief, at 18 (citing 15 U.S.C. § 78o-7(o)(2) which provides that "[n]othing in this subsection prohibits the securities commission . . . of any State from investigating and bringing an enforcement action with respect to fraud or deceit against any nationally recognized statistical organization.").

D. PLAINTIFFS' NEGLIGENCE-BASED CLAIMS ARE ALSO BARRED BY FUNDAMENTAL CONSTITUTIONAL PRINCIPLES

As previously established, (*see* Opening Brief, at 20-25), Plaintiffs' non-fraud claims are also barred by fundamental principles of constitutional law. This is true both because the publicly-disseminated credit ratings that Plaintiffs seek to attack are non-actionable expressions of opinion and because Plaintiffs fail to allege that the CRAs acted with actual malice.

Plaintiffs respond by again citing to only one decision, *Abu Dhabi Commercial Bank* v. *Morgan Stanley & Co.*, 651 F. Supp. 2d 155 (S.D.N.Y. 2009), which actually serves to reinforce the CRAs' First Amendment protections in this case. The court in *Abu Dhabi* recognized unequivocally that "[i]t is well-established that under typical circumstances, the First Amendment protects rating agencies, subject to an 'actual malice' exception, from liability arising out of their issuance of ratings and reports because their ratings are matters of public concern." *Id.* at 175. The decision is in accord with the extensive body of case law that has repeatedly and consistently recognized that, at its core, the CRAs' speech – opinions about securities that are disseminated to the investing public – implicate the First Amendment and are entitled to its protections. *See, e.g., Compuware*, 499 F.3d at 529; *Jefferson County School District No. R-1* v. *Moody's Investor's Services, Inc.*, 175 F.3d 848, 856 (10th Cir. 1999); *County of Orange* v. *McGraw Hill Cos.*, 245 B.R. 151, 157 (C.D. Cal. 1999); *In re Enron Corp. Securities, Derivative & "ERISA" Litigation*, 511 F. Supp. 2d 742, 808-27 (S.D. Tex. 2005).

While acknowledging that the First Amendment applies in "typical circumstances," the court in *Abu Dhabi* found that at the motion to dismiss stage it was bound to accept the affirmative and specific allegations made by the plaintiff in that case that the ratings on a particular and identified issuer "were never widely disseminated, but were provided instead in connection with a private placement to a select group of investors." 651 F. Supp. 2d at 176. As such, the court held that

dismissal on First Amendment grounds was not appropriate at that procedural stage. No such circumstances are, or could be, alleged here. Indeed, Plaintiffs here explicitly acknowledge that the CRAs' ratings on Fannie Mae and Freddie Mac were "published," (SAC at ¶ 18), and "made by the Defendants to the *group of investors* that included the Plaintiffs." (Pl's Opp. at 18). This fact is further evidenced by the ratings reports themselves. *See* September 13, 2010 Declaration of David T. Biderman in Support of Joint Motion to Dismiss, Exs. A and B; *see also* September 13, 2010 Declaration of Joshua M. Rubins, exs. 1 and 2.[6] There can be no serious dispute, therefore, that the ratings in this case – ratings which are of the highest public concern because they relate to Government-Sponsored Enterprises that receive support from the Federal government and assume public responsibilities – fall within the "typical circumstances" consistently recognized by the courts. *See, e.g.,* http://www.fanniemae.com/kb/index?page=home&c=aboutus (defining Fannie Mae as a Government-Sponsored Enterprise).

Plaintiffs also argue that the CRAs' credit ratings lack First Amendment protection because they relate to "economic activity." Pl's Opp. at 17-18. This argument is flatly wrong as a matter of law and lacks any support whatsoever in decades of relevant First Amendment precedent. *See New York Times* v. *Sullivan*,

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[6] Plaintiffs argue that the Court may not consider these declarations. The Ninth Circuit has clearly held, however, that a "court may consider 'material which is properly submitted as part of the complaint' on a motion to dismiss without converting the motion to dismiss into a motion for summary judgment," (*Lee* v. *City of Los Angeles*, 250 F.3d 668, 688-89 (9th Cir. 2001)), and that a defendant may place before the court such documentation even if "the document are not physically attached to the complaint" so long as the plaintiff does not challenge the "authenticity" of the document and the "complaint necessarily relies" on them. *Id.* (citation omitted). "Second, under Fed. R. Evid. 201, a court may take judicial notice of 'matters of public record.'" *Id.* Here, the CRA Declarations and attached documentation were offered merely for the limited purpose of establishing the existence of the judicially noticeable fact that each CRA is headquartered in New York. Opening Brief, at 19 n.10. Moreover, the publications attached to the CRA Declarations were referenced in the SAC when Plaintiff alleged that the CRAs published their ratings on Fannie Mae and Freddie Mac. SAC at 17 (stating that Moody's and S&P published the ratings allegedly assigned by each CRA to the Fannie Mae and Freddie Mac securities).

376 U.S. 254, 266, 84 S. Ct. 710, 718, 11 L.Ed.2d 686 (1964) ("The publication here was not a 'commercial advertisement' . . . . It communicated information, expressed opinion . . . . That the Times was paid for publishing the advertisement is as immaterial in this connection as is the fact that newspapers and books are sold."); *Burstyn* v. *Joseph Wilson, Inc.*, 343 U.S. 495, 501-02, 72 S. Ct. 777, 780, 96 L.Ed. 1098 (1952) ("It is urged that motion pictures do not fall within the First Amendment's aegis because their production, distribution, and exhibition is a large-scale business conducted for private profit. We cannot agree. That books, newspapers, and magazines are published and sold for profit does not prevent them from being a form of expression whose liberty is safeguarded by the First Amendment. We fail to see why operation for profit should have any different effect in the case of motion pictures."). A particularly apposite case is *Lowe* v. *SEC*, 472 U.S. 181, 210 n.58, 105 S. Ct. 2557, 2573 n.58, 86 L.Ed.2d 130 (1985), in which the Supreme Court observed that "because we have squarely held that the expression of opinion about a commercial product such as a loudspeaker is protected by the First Amendment, . . . it is difficult to see why the expression of an opinion about a marketable security should not also be protected." *Id.* (citation omitted).[7]

[7] Plaintiffs invocation of California's anti-SLAPP statutes is equally unpersuasive in the context of the protections afforded the CRAs' opinions by the First Amendment. The anti-SLAPP statute reflects California's efforts to provide some forms of expression heightened protection against lawsuits that may seek "to chill the valid exercise of the constitutional rights of freedom of speech." Cal. Civ. Proc. Code § 425.16(a). This special motion to strike is not available to a defendant when an action is "brought against a person primarily engaged in the business of selling or leasing goods or services, including, but not limited to, insurance, securities, or financial instruments, arising from any statement or conduct by that person" when the statements are "representations of fact" designed to promote or sell the product to a potential purchaser. Cal. Civ. Proc. Code § 425.17. The CRAs' opinions do not fit within the anti-SLAPP exception – they are opinions, not representations of fact. Nor do they deal with the defendants themselves or any competitor of the defendants, a prerequisite to application of the exception. *See Simpson Strong-Tie Co., Inc.* v. *Gore*, 49 Cal.4th 12, 30 (2010) (holding that the anti-SLAPP exception applies only to "representations of fact about [the defendant's] or a business competitor's

Plaintiffs alternatively argue that they have alleged actual malice here by pointing to their formulaic and rote recitation of the standard set forth in the SAC as grounds for California Civil Code § 3294 "entitling Plaintiffs to punitive damages in an amount appropriate to punish or set an example of Defendants." (SAC at ¶ 44; Pl's Opp. at 18-19). As established in the CRAs' Opening Brief, these sort of conclusory allegations are wholly insufficient to support a finding of actual malice in connection with the Fannie Mae and Freddie Mac ratings. *See Enron*, 511 F. Supp. 2d at 825 (finding insufficient to establish actual malice the "conclusory allegations regarding the CRAs" because such allegations do not "satisfy any of the specific, enhanced pleading requirements established by courts to overcome First Amendment protection"). *See also Barger* v. *Playboy Enterprises, Inc.*, 564 F. Supp. 1151, 1156 (N.D. Cal. 1983) (conclusory allegation that defendant acted "recklessly" was insufficient to constitute an allegation of actual malice); *Shamley* v. *ITT Corp.*, 869 F.2d 167, 173 (2d Cir. 1989) (allegations of malice "must be supported by sufficient evidentiary facts").

E. LEAVE TO AMEND THE FIRST AMENDED COMPLAINT SHOULD BE DENIED BECAUSE SUCH LEAVE WOULD BE FUTILE

Plaintiffs have already had three opportunities to set forth facts that support viable causes of action. Having considered and chosen not to address any of the numerous deficiencies identified on multiple occasions by both the Court and the CRAs, Plaintiffs should not now be granted yet another chance to attempt to state a claim. Any such attempt would be futile for the reasons set forth more fully at 2-17, *supra*.

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business operations, goods, or services"). In any event, that section does not purport to (and could not) delineate the line between protected and unprotected speech under the First Amendment. California was not constitutionally obliged to enact the anti-SLAPP statute at all and its decision about what speech to protect under a procedural statute does not and could not affect the determination of what the First Amendment does protect.

III. CONCLUSION

For the foregoing reasons, the CRAs respectfully request that the Court grant their motion to dismiss with prejudice the claims asserted against them in the SAC.

DATED: October 8, 2010

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PROOF OF SERVICE BY MAIL

I am a citizen of the United States and employed in Los Angeles, California. I am over the age of eighteen years and not a party to the within-entitled action. My business address is 1888 Century Park East, Suite 1700, Los Angeles, California 90067-1721. I am readily familiar with this firm's practice for collection and processing of correspondence for mailing with the United States Postal Service. On October 8, 2010, I placed with this firm at the above address for deposit with the United States Postal Service a true and correct copy of the within document(s):

DEFENDANTS' JOINT REPLY MEMORANDUM OF LAW IN SUPPORT OF MOTION TO DISMISS THE SECOND AMENDED COMPLAINT

in a sealed envelope, postage fully paid, addressed as follows:

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Following ordinary business practices, the envelope was sealed and placed for collection and mailing on this date, and would, in the ordinary course of business, be deposited with the United States Postal Service on this date.

I declare that I am employed in the office of a member of the bar of this court at whose direction the service was made.

Executed on October 8, 2010, at Los Angeles, California.

Helen E. Mays